

MINUTES

BOARD OF TRUSTEES OF THE PUBLIC EMPLOYEES' RETIREMENT FUND 143 West Market Street, Suite 500 Indianapolis, IN 46204

October 12, 2001

Trustees Present

Richard Doermer, Chair
Nancy Turner, Vice Chair
Jonathan Birge
Teresa Ghilarducci (by telephone)
Steven Miller

Others Present

Mike Gery, Executive Assistant to the Governor
James Sperlik, Indiana Legislative Services Agency
Stephanie Rhinesmith, Indiana Development Finance Authority
Stephanie Grieser, William M. Mercer Investment Consulting
Micah Fannin, William M. Mercer Investment Consulting
Mary Beth Braitman, Ice Miller
Eric Swank, Ice Miller
Doug Todd, McCready & Keene, Inc.
Karen Franklin, National City Bank
E. William Butler, PERF Executive Director
Patricia Gerrick, PERF Chief Investment Officer
Joe Duncan, PERF Investment Analyst
Diann Clift, PERF MIS Director
Ed Gohmann, PERF Legal Counsel
Bill Hutchinson, PERF Director of Benefits Administration
Patrick Lane, PERF Director of Communications
Tim Legesse, PERF Investment Analyst
Doug Mills, PERF Chief Financial Officer
Jim Osborn, PERF Project Director
Tom Parker, 1977 Police and Firemen Fund Director
Lynda Duncan, Minute Writer

ITEMS MAILED TO THE BOARD PRIOR TO MEETING

- A. Agenda of October 12, 2001 Meeting
- B. Minutes:
 - ❑ September 7, 2001 Board of Trustees Meeting
 - ❑ September 7, 2001 Benefits Advisory Committee Meeting
 - ❑ Reports, Summaries, Memorandums and/or Letters Concerning:
 - ❑ Actuarial Rate Calculations for Noble County
 - ❑ Legislators' Loan Program
 - ❑ PERF Telecommunications Project
 - ❑ State Hiring Freeze
 - ❑ Property Management Update
 - ❑ Legal Issues relating to Legislator Loans
 - ❑ Documents presented at the 1977 Police and Fire Advisory Committee Meeting
 - ❑ Governor's High Performance Government – Economic Functional Report

Prior to the meeting, a Strategic Planning Update Session was conducted for the Board of Trustees by Nancy Williams of William M. Mercer (report on file). The regular meeting of the Board then followed. A quorum being present, the meeting was called to order.

1. MINUTES APPROVAL

MOTION duly made and carried to approve the Minutes of the September 7, 2001 meeting of the Board of Trustees.

Proposed by: Nancy Turner

Seconded by: Jonathan Birge

Votes: 4 for, 0 against, (Steven Miller absent for the vote)

2. DISCLOSURES

Richard Doermer – Bank One stock ownership.

3. ADMINISTRATIVE

Executive Director's Report:

Line of Duty Deaths.

MOTION duly made to grant a line of duty death award to the survivor of Mr. Daniel Starnes of Morgan County Sheriff's Department who was shot and subsequently died of wounds sustained while conducting a traffic stop.

Proposed by: Jonathan Birge

Seconded by: Nancy Turner

Votes: 4 for, 0 against, (Steven Miller absent for the vote)

Telecommunications Project. The Director advised that the Request for Proposal (RFP) had been withdrawn by PERF and all of the responding parties had been notified that PERF and TRF would republish the RFP jointly at some time in the future. TRF had indicated its desire to be a requestor.

RIPEA Proposals. The Director had communicated to RIPEA that it was the Board's intention at this point neither to become an advocate nor to oppose their legislative recommendations, particularly since this would involve benefit changes.

Property Management Update. A schedule had been provided listing property developments in PERF's Buildings 125 and 143.

Board Meetings 2002. This subject was deferred for resolution at the Annual Board Meeting to be held on November 9, 2001.

Noble County. At the Director's request, Doug Todd of McCready & Keene, Inc. had recalculated the employer contribution rate for Noble County to encompass results of House Bill 1600 from the 2001 session of the General Assembly, which effectively transferred the employer reserve credit from McCray Hospital to Noble County. His conclusion was that the actuarially required contribution rate would be 1%. It was currently 4.5%. House Bill 1600 mandated that the Board should transfer the entire value of the assets and liabilities attributed to the Hospital's participation in the Fund to the account of the County where the hospital was located. The 1% rate is based on the smoothing rules that were adopted by Board Resolution 99-07. The Noble County Commissioners had contacted PERF stating that since they were over-funded they should not pay 4.5% in employer contribution rates. Members of the PERF staff had visited Noble County authorities to discuss their request. It was noted that if their contribution rate were to be recalculated, the minimum rate they would be obliged to pay was 1%, regardless of the funded status. They questioned the rationale for paying 1% but agreed for this to be taken before the Board. It was recommended that:

- Given the unique situation of Noble County, that the employer contribution rate would be recomputed to take into effect the actuarial results of House Bill 1600 for 2001 and to communicate this to Noble County.
- It was noted that there were very few units that were as significantly overfunded as Noble County. Noble County had requested a zero contribution rate given that they were 255% funded. Below 1% would violate the smoothing rules, although, from an actuarial point of view there would be no problem in accepting a 0% employer contribution.
- It was recommended that any changes to the 1% minimum contribution should include a minimum funding ration.

- It was recommended to reduce the Noble County contribution rate to 1% for this year and then to consider at a future Board meeting an amendment to the smoothing rules to permit 0% contribution, if certain tests were met.

MOTION. It was recommended that a draft resolution be prepared and presented to the Board that would possibly include a 3-year term at minimum levels of overfunded status.

Proposed by: Jonathan Birge

Seconded by: Nancy Turner

Votes: 4 for, 0 against (Steven Miller absent for vote)

Information Technology Update.

- SIRIS System. Development of Stage II has been completed in Columbus, Ohio. Navigant had started work on cleaning data to be rotated into the SIRIS Stage I system. Employers were being requested to certify their missing data Navigant located for each of their employees. This project would probably be wrapped up late November/early December 2001. Mr. Doermer considered that there had been some miscomprehension about the task of the Navigant program, in that Navigant was not reviewing and cleaning-up the entire database, only a portion. It would probably take 2 or more years to clean up the entire database. The current program was a pilot program that involved the top 20 employers, which would assist in the development of the process for all the other employers. Board approval would be sought for implementation of the next stage at the beginning of 2002.
- Data and phone lines were being installed in PERF's Building 125.
- Electronic Employer Reporting. This is a pilot project that would enable employers to report electronically, if they are not already doing so. A program had been created on disk whereby wage and contribution information could be provided and returned to PERF. Only 25-30 employers report electronically; the rest report on paper.

Legal Matters. Ed Gohmann, PERF's Legal Counsel presented 4 sets of proposed administrative rules that were ready for final adoption.

- Legislator Loan Rules (LSA Document #01-196). Copies of the Minutes of the Preliminary Hearing on the Legislator Loan Rules were provided. The proper notices and documents had been published in the Indiana Register. No comments were received, and at the meeting no members of the public testified. These are the same rules that the Board approved at its August meeting but a public hearing was necessary for final approval. These would now be forwarded to the Office of the Attorney General and then to the

Governor's Office. There was a requirement for the rules to be formally adopted by January 1, 2002. The maximum loan amount would be the lesser of one-half of the account balance or \$50,000, with a maximum term of 5 years. The interest rate was fixed at the prime rate plus 1% using the prime rate published on the first day of the quarter in which the loan application was submitted.

MOTION duly made to adopt the Legislator Loan Rules in LSA Document #01-196.

Proposed by: Jonathan Birge
Seconded by: Steven Miller
Votes: 5 for, 0 against, no abstentions

- Readopted Rules. (LSA Documents #01-216, #01-217, and #01-218). Copies of the minutes of the Preliminary Hearing were provided. Three sets of readopted loan rules were provided for approval. Under State Law, any rules that were in effect before January 1, 1996 would expire on January 1, 2002. The proper notices and documents had been published in the Indiana Register. A preliminary public hearing had been held and no comments/testimony were received relating to the readopted rules.

MOTION duly made to adopt the proposed readopted rules contained in LSA Documents #01-216, #01-217, and #01-218.

Proposed by: John Birge
Seconded by: Nancy Turner
Votes: 5 for, 0 against, 0 abstentions

FYI Item. Copies of a letter were provided from the National Association of State Retirement Administrators (NASRA) to the President, the President of the SEC and other congressional leadership, on NASRA letterhead, over signature of the president of the Association, stating the continued support for the national markets. The letter was signed by a number of NASRA and NCTR directors, including Dr. William Christopher of TRF and Bill Butler of PERF.

4. BENEFITS ADVISORY COMMITTEE REPORT. The Benefits Advisory Committee had met that morning. Highlights of the meeting included:

- Information from Ms. Roberson, Director of the State Personnel Department, on a proposal to work with PERF on a Staff option for an Outreach Program;
- State Hiring Freeze;
- Meeting of Employer Advisory Group (EAG). The EAG, involving 7 employers, had met on October 11, 2001 to address general issues relating to the function and formation of the group.

Joint/Survivor Option. The Board was advised that under Federal law, a joint/survivor option was required to be included in the Pension Agreement as the default option and a notarized statement would be required if this survivor option were to be waived in favor of a single-life annuity. Several of the larger States have imitated the Federal law by adopting this default option. Although the Board did not have the authority to implement this requirement, support for a joint survivor option as default was voiced. Legislation would be required to change the default option to ensure that a joint and survivor would be the preferred default selected. Jonathan Birge recommended that the Board should support this issue in order for it to be adopted legislatively. It was recommended that this be addressed within the forum of the Pension Management Oversight Commission (PMOC) next summer.

5. 1977 FUND ADVISORY COMMITTEE. Tom Parker provided highlights of the 1977 Police & Firefighters Advisory Committee meeting held on September 18, 2001. The Advisory Committee comprises 2 Police Officers, 2 Firefighters, 2 Mayors and 2 Council members.

➤ Line of Duty Death (see above);

➤ Deferred Retirement Option Plan (DROPS).

- PERF's advisers at Ice Miller and McCreedy & Keene were researching this concept. Mary Beth Braitman advised the Board that this concept had received considerable interest and would be presented before the PMOC and at the Pension Secretaries' Seminar on October 29. It was noted that the Pension Secretaries' Seminar provided a good forum for communicating new legislation to PERF's clients and to discuss questions arising from the administration of local plans.
- A DROP has so far been of interest primarily to police officers and firefighters. The Indiana Association of Cities and Towns (IACT) had said that they are interested in finding out more about the concept, which had been popular in some states and local areas for several years. A DROP enables a retiring public safety officer to take out some amount of money as a lump sum at the front end of retirement. In some jurisdictions, these are very elaborate plans.
- The DROP concept, designed to be actuarially neutral, had been presented at the Benefits Advisory Committee. The implications of opting for a DROP would be additional work for PERF but no increase in money in terms of benefits. The concept is of benefit to both labor and management. Some cities and towns favored DROPS because they provide a certainty for their retirement patterns since members participating in a DROP would declare in advance when their retirement

would be. It was of interest to the participating members since it provided additional flexibility in retirement planning. Currently, members do not have this option and their pension is paid as lifetime monthly benefit with no cash out options (as exists for civilian PERF members).

- Senator Harrison, Chairman of PMOC, had indicated his willingness to look at this in the PMOC. In the Fall IACT meeting, the issue of DROPs had been discussed with several employers who had indicated their interest in it. There are several design questions that need to be worked through. All parties, police and firefighters and IACT, are looking at this only if it can be implemented in an actuarially neutral manner.
- Legislators' Loan Program. Eight applications from legislators had been received to date (one had closed and four more had set closing dates). All Related documentation has been finalized (financial agreements, promissory notes, disclosure statements). Borrowers were being made aware of the potential ramifications of participating in such loans in that they were essentially borrowing from their defined contribution plan account assets. There were limitations to the amount that could be borrowed, viz. the lesser of \$50,000 or 50% of their account. The loans included default provisions, i.e. reporting to the IRS as a distribution on a 1099 in the case of default. The question was raised on the impact of this type of loan if it were to be offered to all PERF members. It was noted that if this involved annuity savings accounts, this could impact on the portfolio that included these funds. The legislators' accounts are not invested in the Guaranteed Fund.

6. INVESTMENTS.

- a. Investment Committee Report. The PERF Investments Committee met on October 5, 2001. Items addressed included the structure of the domestic and international equity allocation, a review of global equity strategies and proposed implementation plan. Pat Gerrick provided an overview of PERF's current domestic equity allocation. Stephanie Grieser of Mercer provided historical information on the asset allocation study and approved investment objectives. The Fund's exposures by style, growth, capitalization, etc. were reviewed. The following recommendations were noted:
 - Utilize concentrated active strategies to realize alpha.
 - Passive Strategies were favored in efficient markets.
 - Utilize Active strategies in less efficient sectors (mid cap, small cap and international equity).
 - Total equity exposure should remain style and capitalization neutral.

- Continue managing the majority of the domestic equity portfolio in Passive/Enhanced strategies
- Adopt Global Equity strategies for alpha generation. This would not change the Fund's overall allocation to international and domestic equity. The overall allocation approved by the Board remains. Rational: As markets have become more global, the opportunity exists for managers to add value by investing in their best ideas no matter where the company is domiciled. Currently, the global equity market as represented by MSCI ACWI is approximately 50% US and 50% non-US. Allocations for global would be funded 50% from large cap domestic exposure and 50% from international equity exposure.

Mr. Doermer asked if this would entail less risk. He was advised that this would provide more opportunity since managers would have a broader investment universe. In the global equity category, approximately 50% of the stocks are in US firms as distinguished from international equity where there was no US. This enables managers to globally execute their best ideas within a sector.

MOTION duly made to adopt the new equity target exposures and global investment allocation as approved by the Investment Committee. The Fund's Investment Policy will be amended to reflect these targets. The recommended ranges and rebalancing policy will be reviewed at a subsequent meeting.

Proposed by: Jonathan Birge
Seconded by: Steven Miller
Votes: 5 for, 0 against, 0 abstentions

Mr. Doermer noted that the recommended strategies are expected to significantly improve the risk-adjusted return of the Fund's equity exposure.

Global Equity Allocation. The Board discussed the possibility of including Brandes in the search for a global equity manager since the firm would close their global equity product on November 30. Brandes is a global equity manager that invests worldwide and they have an excellent performance record. To hire them as a Fund Manager, it would be necessary to expedite the due diligence process. As public Trustees, the Board had a responsibility to carry out the due diligence process. Ed Gohmann had reviewed the question raised by the Investment Committee on whether the Board could select an Investment Manager without an RFP. The Board's investment procurement policy, as currently written, would prohibit the selection of a manager without an RFP but the Board could change its policy. According to the general public procurement statutes, because of the Fund's status as a body corporate politic, the public purchasing statutes did not apply. Mr. Gohmann noted that for the Board to meet its fiduciary duties under the

prudent investor standards, it might be required to select an investment manager with an RFP process, because it could then be established that procedural prudence had been exercised. The Board supported using an expedited RFP process. An RFP notice could be published by October 28 or earlier and the Board would next meet on November 9. Mr. Doermer asked if the RFP process could be satisfied before that date, without violating policy and practices. The same amount of consideration would be given to all firms responding to the RFP, and this would meet the ethical requirements.

MOTION duly made to authorize the publication of an RFP for a Global Equity Value Manager and that this process should be completed and ready for the Board's vote on November 9.

Proposed by: Steven Miller
Seconded by: Teresa Ghilarducci
Votes: 5 for, 0 against, 0 abstentions

MOTION duly made that the Amended Alternative Investment Policy Statement be approved, and these to become the policy guidelines for the alternative assets of the Fund.

Proposed by: Steven Miller
Seconded by: Jonathan Birge
Votes: 5 for, 0 against, 0 abstentions

Steve Miller noted that when previously analyzing alternative investment strategies there had been a misperception that Hedge Funds were undesirable. However, the Investment Committee noted that there were many variations of Hedge Funds and some could reduce risks within a portfolio. The Investment Committee recommended adding a target allocation to hedge funds in the alternatives strategy.

The Board went on to discuss the issue of retaining the services of the SIS as consultant and the following motion was agreed:

MOTION duly made to retain the SIS as the Alternatives Investment Consultant for a period of 1 year.

Proposed by: Steven Miller
Seconded by: Jonathan Birge
Votes: 5 for, 0 against, 0 abstentions

Steven Miller suggested that the current RFP process was not appropriate for selection of Alternative Investment Managers. Staff and SIS were designated to prepare a revised policy for discussion at the next Investment Committee meeting.

- b. Governor's High Performance Government – Economic Functional Report.
The Board was informed that this is an initiative from the Governor's Office to address a number of issues throughout the State government. One of the task forces established as part of the initiative is addressing economic development issues. One of the recommendations of this task force was to encourage the PERF Board to invest up to 5% of its total portfolio for risk ventures in 'seed money for Indiana start-ups'. PERF would be receptive to looking at this sort of investment in Indiana providing they meet the guidelines. The Board requested the staff to contact the Governor's Office to discuss the proposal and obtain more information.

7. NEXT MEETING

The next meeting of the Board was previously set for November 9, 2001.

8. EXECUTIVE SESSION

An Executive Session of the Board followed to discuss personnel issues.

9. ADJOURNMENT

There being no further business, the meeting was adjourned.